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No. _____

IN THE
SUPREME COURT OF THE UNITED STATES

SCHMITT INDUSTRIES, INC.,
Petitioner,

v.

BALANCE DYNAMICS CORPORATION,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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80pp

QUESTIONS PRESENTED

Whether this Court should resolve the circuit conflict on whether damages can be awarded on the showing of likelihood, as opposed to proof, of liability?

Does awarding damages for false advertising under the Lanham Act on the "likelihood" of the communication being deceptive or misleading involve an impermissible prior restraint of the First Amendment right to free speech?

PARTIES TO THE PROCEEDING

Petitioner

Schmitt Industries, Inc., (Schmitt) is an Oregon corporation, is publicly traded on the NASDAQ, has no parent company or nonwholly owned subsidiaries.

Respondent

Balance Dynamics Corporation (BDC), now BalaDyne Corporation, is, upon knowledge and belief, a privately held Michigan Corporation, and has disclosed no parent companies or nonwholly owned subsidiaries.

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The Opinion of the United States Court of Appeals for the 6th Circuit is reported at 204 F.3d 683 6th Cir (2000); 2000 U.S. App. LEXIS 2773, 2000 FED App. 0068; 53 U.S.P.Q.2D (BNA) 1972 attached as Appendix A. The District Court's Finding of Fact and Conclusions of Law, granting Schmitt's FRCP 50 Motion, 1997 U. S. District LEXIS 17253 (E. D. Mich) is attached as Appendix B. The 6th Circuit's Order denying Rehearing and Rehearing en Banc is attached as Appendix C.

JURISDICTION

The United States Court of Appeals for the 6th Circuit issued its Opinion on February 25, 2000. Petitioner filed a Petition for Rehearing and Rehearing *En Banc* which was denied May 1, 2000. This Petition is filed within ninety days of such denial. The Court's jurisdiction is invoked pursuant to 28 U.S.C. Sections 1254(1) and 2106.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

CONSTITUTION OF THE UNITED STATES OF AMERICA - AMENDMENT 1

Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances.

Lanham Act - 15 USC 1125(a)

(a) Civil Action

(1) Any person who, on or in connection with any goods or services, or any container for goods, uses in commerce any word, term, name, symbol or device, or combination thereof, or any false designation of origin, false or misleading description of fact, or false or misleading representation of fact, which—

(A) is likely to cause confusion, or to cause mistake, or to deceive as to the affiliation, connection, or association of such person with another person, or as to the origin, sponsorship, or approval of his or her goods, services, or commercial activities by another person, or

(B) in commercial advertising or promotion, misrepresents the nature, characteristics, qualities, or geographical origin of his or her or another person's goods, services or commercial activities shall be liable in a civil action by any person who believes that he or she is or is likely to be damages by such act.

Lanham Act - 15 U.S.C. Section 1117(a)

Recovery for violation of rights; profits, damages and costs; attorney fees; treble damages; election

(a) When a violation of any right of the registrant of a mark registered in the Patent and Trademark Office, a violation under section 1125(a), (c), or (d) of this title, or a willful violation under section 1125(c) of this title, shall have been

established in any civil action arising under this chapter, the plaintiff shall be entitled, subject to the provisions of sections 1111 and 1114 of this title, and subject to the principles of equity, to recover (1) defendant's profits, (2) any damages sustained by the plaintiff, and (3) the costs of the action. The court shall assess such profits and damages or cause the same to be assessed under its direction. In assessing profits the plaintiff shall be required to prove defendant's sales only; defendant must prove all elements of cost or deduction claimed. In assessing damages the court may enter judgment, according to the circumstances of the case, for any sum above the amount found as actual damages, not exceeding three times such amount. If the court shall find that the amount of the recovery based on profits is either inadequate or excessive the court may in its discretion enter judgment for such sum as the court shall find to be just, according to the circumstances of the case. Such sum in either of the above circumstances shall constitute compensation and not a penalty. The court in exceptional cases may award reasonable attorney fees to the prevailing party.

STATEMENT OF THE CASE

Balance Dynamics Corporation (BDC) and Schmitt Industries, Inc. (Schmitt) are competitors selling equipment used for the balancing of certain types of industrial equipment, particularly industrial grinders. Schmitt published three complained of communications: a cartoon (Fall, 1992); a letter (March 16, 1993); and an expert's opinion letter (Fall, 1993). BDC brought suit February 14, 1994, contending that such were wrongful under various state claims and under Section 43(a) of the Lanham Act, 15 U.S.C. 1125(a)(1)(B). All of the state, common law and statutory state claims were subsequently dismissed. BDC dropped its request for

injunctive relief August 21, 1994, and proceeded seeking damages only.

BDC, over the course of the litigation, entered into a number of stipulations regarding damages. In the final pre-trial order, BDC stipulated it would not claim nor attempt to prove any lost sales or change in financial position due to the complained of actions of Schmitt.

At trial, following the close of BDC's proofs, Schmitt moved for judgment on the law, contending BDC had failed to prove the elements of its damages claim for false advertising under 15 U.S.C. §1125(a)(1)(B). Schmitt contended BDC failed to present cognizable evidence of actual confusion and materiality. The trial court took the matter under advisement. Schmitt rested. The trial court scheduled final argument and charged the jury, its instructions were objected to by BDC. With the jury in deliberation, the trial court granted Schmitt's Rule 50 Motion. The jury returned a no cause.

The trial court, in its Findings of Fact and Conclusions of Law, held there was no literal falsehood proven. Further, that under a cause of action for damages based upon implied falsehood, BDC could not prevail as a matter of law because it failed to present any evidence of customer confusion which, it held, on authority of *Johnson & Johnson-Merck v. Rhone-Poulenc Rorer*, 19 F.3d 125, 129-30 (3rd Cir. 1994), was a prerequisite to its recovery. The trial court noted that BDC had failed to produce any customer to testify that they were misled or deceived. Therefore, with no such evidence of customer reaction to Schmitt's complained of materials, BDC, as a matter of law, could not maintain a false advertising claim based upon implied falsehood.

BDC appealed timely to the 6th Circuit.

The 6th Circuit reversed the trial court, promulgated a new standard for recovery of "damage control expenses" or "loss control damages" and remanded the case for further proceedings. The 6th Circuit held:

> "similar standards as apply to injunctive relief should also apply to recovery of damage control expenses. That is, damage control expenses should be recoverable upon a showing of the likelihood of confusion, rather that upon a showing of actual confusion itself."

The 6th Circuit ruled the trial court applied the wrong standard. Further, that the testimony of one BDC officer regarding his communications with some unidentified and never produced customers might be sufficient to allow the jury to find a likelihood of confusion. Therefore, under the new standard, the trial court's granting judgment as a matter of law was erroneous and the matter should have gone to the jury. Further, the 6th Circuit found the jury instructions were erroneous as a matter of law and reversible error as they did not reflect the new standard.

To the elements required to sustain an action under the Lanham Act for injunctive relief, the 6th Circuit added the plaintiff must show: "(1) there was a likelihood of confusion or damages to sales, profits or goodwill; (2) its damage control expenses are attributable to the violation (i.e. caused by the violation); and (3) that its damage control efforts were reasonable under the circumstances and proportionate to the damages which was likely to occur" to sustain an award of

cost control damages. Schmitt's request for Rehearing and Rehearing *En Banc* was denied.

ARGUMENT FOR GRANTING WRIT

The opinion in this matter is in direct conflict on the availability of monetary recovery under the Lanham Act. In implied falsehood cases, proof of actual deception of the intended audience has been required for recovery of monetary damages in all the circuits. This is confirmed by the 6th Circuit in the instant opinion. It there states:

> "like many other circuits, we have held that where plaintiffs seek to recovery monetary damages for false and misleading advertising that is not literally false, 'a violation can only be established by proof of actual deception (i.e. evidence that individual consumers perceived the advertisement in a way that mislead them about the plaintiff's product.)' *Podiatric Physicians*, 185 F.3d at 614 (quoting *Sandoz Pharm. Corp. v. Richardson-Vicks, Inc.*, 902 F.2d 222, 229 (3d Cir. 1990))(citations omitted). In *Podiatric Physicians* we also set up a more lenient standard for obtaining injunctive relief under the Lanham Act: "injunctive relief may be obtained by showing only that the defendant's representations about its product have a tendency to deceive consumers. . . ." Id. at 618 (quoting *Max Daetwyler Corp v. Input Graphics, Inc.*, 608 F. Supp 1549, 1551 (E.D. Pa. 1985)). 'This lower standard may protect

the consumer without fear of bestowing an undeserved windfall on the plaintiff.' Id."

The 6th Circuit is the only Circuit to hold contrary with respect to the availability of monetary damages in an implied falsehood setting [1]

In the 6th Circuit – but not the other Circuits – "loss control damages" are to be awarded on a showing defendant's representations have a *tendency or likelihood* to deceive.

Application of this standard will result in plaintiff's windfall recovery whenever the "tendency" or "likelihood"

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[1] This is not to mean that the jurisprudence which has developed surrounding 15 U.S.C. §1125(a)(1)(B) is uniform. See Jean Wegman Burns, "Confused Jurisprudence: False Advertising Under the Lanham Act" 79 B.U.L. Rev. 807 (1999), who at 810 offers the following: "To the extent the federal courts have attempted to place limits on section 43(a)(1)(B) cases, the results are inconsistent and incoherent. Whether reading the section expansively or narrowly, the courts are issuing ad hoc and conflicting decisions on key aspects of the law. They often strain or ignore the statutory language. Different judges latch onto different words in the provision to justify their decisions. Some outcomes have serious implications for First Amendment law and free speech. Not only does this disarray increase the likelihood that any given case will produce results contrary to consumer interests, but it hinders the intended effect of section 43(a)(1)(B). In order for the provision to serve its societal purpose, the courts must develop their understanding of the law's basic policy and goal. Today, without any semblance of a consistent jurisprudence, section 43(a)(1)(B) is, at best, a waste of time and, at worst, harmful to society."

With the present decision, things have worsened and the free speech issue ripened.

turns out to be an invalid assumption. This new standard relieves plaintiff of the requirement of proving the elements required in every other Circuit for an award of monetary damages under the Act. The opinion allows recovery of damages upon mere speculation that elements of the cause of action could be proven.

Further, as promulgated, the opinion acts as an unacceptable restraint on free speech. It allows an award of damages against advertisers whose communications are legitimate, truthful and not misleading. This impermissible standard will have a chilling effect on competitor's messages as they seek to avoid litigation and potential windfall recoveries by their competitors.

The opinion ignores the plain language of the law and applies the wrong standard of liability for a false advertising/promotion case.

This 6th Circuit decision is not only in direct conflict with the decisions of every other United States Court of Appeals, it is in conflict with the general jurisprudence of this country. Until now a plaintiff had to prove its cause of action before liability for damages is found. Now, at least under the Lanham Act, plaintiffs need not prove the elements of their cause of action, they will only have to show they *likely* could meet them to prevail at trial for loss control damages.

The new standard cannot be justified as furthering protection of the consumer. The consumer is adequately protected under the Act. The net result of this ruling is to muzzle the would-be advertiser and better the competitor. The interests of the consumer are harmed by the chilling effect and uncertainty created. The standard wrongfully

shifts the cost of normal competition from one competitor to another in the absence of any proven wrongdoing.

Requirement to prove actual deception to recover monetary damages where advertising has not been found to be literally false had been held throughout the Circuits and, until this opinion, in the 6th Circuit as well. See *United Industries v Clorox Co.*, 140 F.3d 1175, 1182 (8th Cir. 1998); *Willian H. Morris Co. v. Group W, Inc.*, 66 F.3d 255, 258 (9th Cir. 1995); *Johnson & Johnson-Merck Consumer Pharmaceuticals Co. v. Smithkline Beecham Corp.*, 960 F.2d 294, 297-98 (2nd Cir. 1992); *Avis Rent A Car System v. Hertz Corp.*, 782 F.2d 381 (2nd Cir. 1986); *Abbot Laboratories v. Mead Johnson & Co.*, 971 F.2d 6 (7th Cir. 1992); *Electronics Corp. of America v. Honeywell, Inc.*, 358 F. Supp 1230 (D. Mass), *aff'd per curiam*, 487 F.2d 513 (1st Cir. 1973), *cert. denied*, 415 U.S. 960 (1974); *American Counsel of Certified Podiatric Physicians and Surgeons v American Bd. Of Podiatric Surgery, Inc.*, 185 F3d 606 (6th Cir. 1999).

The appealed from Order has created another standard and another major conflict in the Circuits regarding application of the Lanham Act.

The 6th Circuit cites no authority for its holding. It commented it could not find any other authority which had required "marketplace damages", as opposed to "actual damages", as a prerequisite for the awarding of "loss control damages". Therefore, it felt free to create, for the first time, a differentiation in the treatment of "loss control damages" and any other monetary damage award to create a new standard. This is action without authority. The 6th Circuit held when courts have held that actual confusion must be demonstrated before monetary damages are recoverable, they have referred to plaintiffs who were seeking damages which

would have been suffered in the marketplace, i.e., lost sales, lost profits, or loss of goodwill. The 6th Circuit makes no comment or explanation of the fact lost profits are the result of increased costs, including "loss control costs". Regardless of the rhetoric, there is no rational basis for the separation of this form of monetary relief from any other. This is a result, as opposed to principle oriented, decision.

Judicial restraint limits proper judicial actions to those based upon the authority of Congress or *stare decisis*. The award of damages on a likelihood of establishing the tort has support from neither.

The opinion clearly discloses what the 6th Circuit favors as policy and its supporting logic. That properly could have been a discussion within the dicta of the case, suggesting a course of action to Congress. In that manner, the policy could be presented to, debated in, and possibly adopted by Congress. The creation of a "new standard" for recovery under a Federal law directly effecting interstate commerce is of significant importance to national jurisprudence. Such should be the product of advise and consent, not judicial fiat.

ARGUMENT 1 - 15 U.S.C. §1125(a)(1)(B) does not authorize a new standard of liability

The Lanham Act contains in its text no special standard for the proofs required for either injunctive or monetary relief. It relies on general federal jurisprudence. Nothing in the Act authorizes or even hints of authority to assess *damages* against a defendant because there was a *likely* violation of the Act.

General federal jurisprudence controls as to the proofs required for the various forms of relief available, injunctive and monetary. The 6th Circuit offers no authority for the awarding of damages on a "likelihood" standard. Their own opinion concedes this.

The 6th Circuit is awarding damages on the *likelihood*, the *tendency*, that some or all of the elements of the cause of action may occur. It is axiomatic that such a finding is not capable of sustaining recovery by one party against the other. The injunctive relief standard has no application in a damages setting.

ARGUMENT 2 - This is not a case of first impression

Having to deal with claims of damages for costs resulting as the consequence of a tortious act is not unknown in the law generally or the Lanham Act particularly. "Damage control costs" or "loss control damages" are not new. They are a relabeling of what has previously been termed "responsive, reparative or corrective advertising". The 6th Circuit recognized that in its opinion stating:

> "And several courts have awarded damages for the expense of responsive or reparative advertising quite apart from the award of marketplace damages. *See, e.g. ALPO Petfoods, Inc. v. Ralston Purina Co., supra* [997 F. 2d 949 (D.C. Cir. 1993]; *U-Haul Int'l, Inc. v. Jartran, Inc.*, 793 F.2d 1034, 1041 (9th Cir. 1986); *Otis Clapp & Son, Inc. v. Filmore Vitamin Co.*, 754 F.2d 738, 745 (7th Cir. 1985). Although none of these courts

> have awarded damage control costs in the absence of marketplace damages, none have treated marketplace injury as a prerequisite to recovery of damages control costs either." (Emphasis added)

The premise is incorrect.

In *ALPO*, it was proven by the preponderance of the evidence both Ralston and ALPO had violated the prohibitions of the Lanham Act through the publication of literally false advertising and thereby injured each other through their misleading customers. That being found, the court ordered a recovery to allow corrective action. In *U-Haul*, it was proven by a preponderance of the evidence Jartran had published literally false advertisements and, as a result, injured U-Haul. Jartran was ordered to pay U-Haul damages. The cost of the offending advertising campaign was used by the trial court as a measure of estimating the extent -- not the existence -- of the damages to U-Haul. In *Otis Clapp*, the defendant admitted liability and the only issue in the case was the determination of the damages caused by the violation. Loss control costs, loss control damages, corrective, responsive or reparative damages are admitted to be recoverable *after liability is proven*.

In the present case, the trial court found no literal falsehood and the 6th Circuit did not disturb that finding. The jury returned a verdict of no cause of action. The 6th Circuit opinion does not find that actual confusion or materiality was established. Rather, it remands the case to the trial court to determine if plaintiff can establish a "*likelihood* of confusion" and, if it can, holds that alone is sufficient to assess an award of loss control damages against defendant.

In each of the cited cases, the costs of responsive and reparative advertising expenses were awarded to cover the cost of response to damages which were proven to have occurred as result of the defendant's proven or admitted violation of the Lanham Act. All elements of the cause of action were established by a preponderance of the evidence. In each case, actual, not a *likelihood* or *tendency* of, confusion and materiality were *proven* before damages were assessed.

There is no authority to award monetary relief on the injunctive relief standard. Without proof of actual misrepresentation there can be no recovery. It is elemental that unless all of the elements are *proven* there is no violation of the Lanham Act upon which to justify an award of damages. A showing of a "likelihood" or "tendency" is not enough in a false advertising action.

ARGUMENT 3 - The opinion, as the 6th Circuit seeks to enforce it, acts as a prior restraint and is, therefore, violative of the U.S. Constitution's right to free speech.

The activities which are the subject matter of 15 U.S.C. §1125(a)(1)(B) are speech. This Court has accorded limited Constitutional protection to commercial speech. It has held such speech which is not false, deceptive or misleading can be restricted, but only if the State shows the restriction directly and materially advances a substantial state interest in a manner no more extensive than necessary to serve that interest. *Central Hudson Elec. & Gas Corp. v. Public Serv. Comm'n of N.Y.*, 447 U.S. 557, 566; 65 L.Ed. 2d 341, 100 S.Ct. 2343 (1960) The communications of Schmitt, not having been determined to be in violation of the law, are legitimate communication of a competitor. BDC's costs are

its response to competition, which, if it is not illegal, are costs which are fairly and properly BDC's cost of doing business. The workings of the free market, the dissemination of information to potential customers, the solicitation of business and the statement of opinions all have societal benefit. While this speech may be commercial speech, it is not totally unprotected. Application of the new 6th Circuit rule, awarding damages upon a *likelihood* of confusion, will certainly have a chilling effect on commercial speech. That restriction of a protected freedom is not required to accomplish societal goals, especially when injunctive relief and damages are available to a complainant. The new standard and the chill it will place on advertising cannot pass Constitutional scrutiny. Speech which is in violation of the Lanham Act can be enjoined and, if all of the elements are met, result in a damage award to persons injured. Legitimate speech must not be unnecessarily burdened by an improper application of a Federal law.

Speech (advertising and promotional activities) which is not false, misleading or deceptive is not a violation of the Lanham Act. There is no justification to burden legitimate and protected speech with the imposition of a special lower standard for recovery. Such will undoubtedly reduce the attractiveness of the exercise of the right. If commercial speech is unduly restricted, such will lower the level of competition, the exchange of information will decrease and the efficiency of the marketplace will fall, to the detriment of all. Schmitt would not communicate to the marketplace the truth regarding BDC's products if it had known that would result in litigation which would consume years of effort and hundreds of thousands of dollars. This, regardless of the fact that the communications were found by the trial judge and jury (and, hopefully, this Court) to be unobjectionable. The chill is here.

The results of the cases cited by the 6th Circuit (*ALPO, U-Haul* and *Otis Clapp*) could not have been sustained had the respective plaintiffs determined not to even attempt to show the effect of the wrongful behavior on the intended audience. In the instant matter, BDC stipulated it had no and would make no claim for lost sales or change in financial position resulting from the Schmitt's complained of activity. (BDC's final stipulation, in the pre-trial order, should have ended its claim for increased costs, including "damage control costs". Such are clearly a change in financial position and the reciprocal to "lost profits".)

The 6th Circuit's holding will apply the "likelihood" standard to some of the largest Lanham Act recoveries. What the 6th Circuit labels "damage control costs" are the reparative advertising awards in *ALPO* ($10.4 Million) and *U-Haul* ($40 Million). Those awards were based on liability, materiality and damages *proven*, not on showing of a tendency or likelihood of establishing liability.

The principals of the law remain the same regardless of the magnitude of the damages claimed. Whether the damages claimed are one dollar or one billion dollars, they are not recoverable until liability is established.

The 6th Circuit's establishment of this new standard of liability is dangerous and a constitutional violation upon application.

ARGUMENT 4 - The "likelihood of confusion" standard should not be applicable to any false advertising action.

15 USC 1125(a) prohibits practice of a myriad of anti-competitive and fraudulent activities. Among them are trade dress violations, misstatements of affiliation or origin, palming off and reverse palming off. Liability for such violations is predicated on meeting the standard, burden of proof, stated in §1125(a)(1)(A) of the Act: *i.e.* the complained of actions are "likely to cause confusion, or to cause mistake, or to deceive". This because they are property right related and occur when one party seeks to trade off the reputation of another by fooling the public into thinking they are buying another's goods. The "likely to deceive, confuse or cause mistake" makes perfect sense in that setting. Congress selected the standard and it should be enforced in those settings.

The Lanham Act also prohibits false advertising - unrelated to and independent of trade dress, misstatement of origin and the other "traditional" violations.

In 1988 Congress amended the language of the Act. There, Congress separated the "traditional" Lanham Act actions from false advertising and promotion cases and gave each a different standard of proof to establish liability. With the passage of 15 U.S.C. 1125 (a)(1)(B), Congress made "misrepresents" the standard to be met to establish false advertising liability.

It is true that early case law commonly did not differentiate between the different causes of action or assign different standards. That, at least in part, was because the initial listing of activities prohibited by §1125(a) were

contained in a single paragraph.[2] Therefore, before the amendment, the courts could and did reasonably interpret the Act to require the same standard for relief, injunction or monetary, for all violations of the section. Early case law intermixed decisions for false advertising with trade dress, palming off, etc. After the 1988 Amendment, the authority for that in the statute disappeared, but the intermixing of standards for various 15 USC 1125(a) causes of action continue.

Presently all Circuits, except the 6th, in claims of literally true but implied falsehood, require at least some evidence of the deception caused by the alleged misrepresentation on the intended audience. There must be some customer/marketplace proof of actual deception. *See United Industries v Clorox Co.*, 140 F.3d 1175, 1182 (8th Cir. 1998); *Willian H. Morris Co. v. Group W, Inc.*, 66 F.3d 255, 258 (9th Cir. 1995); *Johnson & Johnson-Merck Consumer Pharmaceuticals Co. v. Smithkline Beecham Corp.*, 960 F.2d 294, 297-98 (2nd Cir. 1992); *Avis Rent A Car System v. Hertz*

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[2] Prior to the 1988 amendment, subsec. (a) read as follows: "Any person who shall affix, apply, or annex, or use in connection with any goods or services, or any container or containers for goods, a false designation of origin, or any false description or representation, including words or other symbols tending falsely to describe or represent the same, and shall cause such goods or services to enter into commerce, and any person who shall with knowledge of the falsity of such designation of origin or description or representation cause or procure the same to be transported or used in commerce or deliver the same to any carrier to be transported or used, shall be liable to a civil action by any person doing business in the locality falsely indicated as that of origin or in the region in which said locality is situated, or by any person who believes that he is or is likely to be damaged by the use of any such false description or representation."

Corp., 782 F.2d 381 (2nd Cir. 1986); *Abbot Laboratories v. Mead Johnson & Co.*, 971 F.2d 6 (7th Cir. 1992); *Electronics Corp. of America v. Honeywell, Inc.*, 358 F. Supp 1230 (D. Mass), *aff'd per curiam*, 487 F.2d 513 (1st Cir. 1973), *cert. denied*, 415 U.S. 960 (1974); *American Counsel of Certified Podiatric Physicians and Surgeons v American Bd. Of Podiatric Surgery, Inc.*, 185 F3d 606 (6th Cir. 1999).

Presently, the 3rd Circuit is requiring, in implied falsity cases, not only proof of actual deception, it is also requiring proof the deception effected a "substantial number" of the intended audience. *Johnson & Johnson-Merck v. Rhone-Poulenc Rorer*, 19 F.3d 125, 134-36 (3rd Cir. 1994). In that case, the 3rd Circuit found there was insufficient evidence that a substantial number of the intended audience were proven to be deceived or mislead, and therefore permanent injunctive relief was unavailable. In the instant case, one of BDC's officers spoke of his impressions and reactions to the March 16, 1993 letter which had been sent to 3200 Schmitt customers and contacts. He related that one of BDC's customers, unidentified during discovery and at trial,[3] faxed a copy of the Schmitt letter to BDC. It was his further testimony he spoke with perhaps a total of 40 individuals in 10 or 12 companies regarding the issues raised. Assuming 40 contacts out of the 3200 letters sent, some of which contacted BDC and others who were contacted by BDC, the total percentage of contacts was 1.25% of the "intended audience". He further testified that over the next two years sales went up and BDC's prices were not reduced. No testimony, not even hearsay, went into the record regarding customer reaction to

[3] Due to BDC's stipulations that would not bring any proofs as to damages or lost sales or change in financial position, BCD maintained his identity and all other customer identification and financial information was irrelevant and not subject to discovery.

either the cartoon or Schmitt's expert's opinion letter. Compare this "standard" for granting of injunctive relief in the 3rd Circuit in *Johnson & Johnson, supra* to the award of "loss control damages" on the injunctive relief standard of the 6th Circuit. The conflict is clear.

In light of BDC's failure to bring even one of those customers as a witness, the trial court found BDC had failed to meet its burden of proof to show the effect of the implied falsehood on any of the intended audience. The issue of materiality to the purchasing decision was never reached except again by a self-serving statement of BDC's officer and an attempt to qualify another of BDC's employees as a previously unnoticed expert on the market and materiality (which the trial court would not allow). The 6th Circuit held in *Podiatric Physicians*: "A plaintiff relying upon statements that are literally true yet misleading "cannot obtain relief by arguing how customers could react; it must show how customers actually do react." That was in accord with most of the rest of the Circuits until it too was abrogated. The 6th Circuit now holds, directly contrary to the other Circuits and its own *stare decisis*, that the hearsay testimony of a non-customer and officer, employee and equity holder of the plaintiff is sufficient to get past a FRCP 50 motion and to the jury. Nothing was mentioned about the essential dirth of testimony on the materiality element of the Lanham Act cause of action. The 6th Circuit instead remanded, instructing the trial court to assess loss control damages on a likelihood, a tendency, of confusion. This, as has been stated before, is wholly without precedent.

To reach its result, the 6th Circuit, in conflict with every other Circuit, used an injunctive standard to assess of damages. To do that, the 6th Circuit ignored the plain

language of the law and *stare decisis* both in the 6th and other Circuits.

Since 1988, the standard of proof required to sustain an action under §1125(a)(1)(A) is "likely to cause confusion", or "to cause mistake, or to deceive". The use of that standard to determine liability in a false advertising and promotional materials case is no longer supported in the amended law. "Misrepresents" is the correct standard for a finding of liability in false advertising cases. That standard was set by Congress. It is unambiguous and a term of defined meaning in the jurisprudence. The two subsections, (A) and (B) are separated by the disjunctive "or".

The 6th Circuit not only erred in formulating its new "likelihood" standard for recovery of "loss control damages", it errs in the application of the "likelihood of confusion" to false advertising actions generally. Applying the "likelihood" standard for establishing liability for violation of §1125(a)(1)(B) is no longer authorized. Perhaps the addition of the word "commercial" and misrepresent standard are Congress's effort to avoid the free speech issue. The 6th Circuit's "likelihood" basis for liability for damages has crossed the line and ventured well into the prior restraint territory.

ARGUMENT 5 - The trial court's jury instructions were correct.

The Sixth Circuit found the trial Court's jury instructions were infirm, prejudicial and erroneous as a matter of law. It assigned error because the jury was instructed BDC, in order to sustain its case, must show an actual deception of the customers, that the deception was material in

that it effected their purchasing decisions and that as a result BDC was injured. The jury instructions required BDC to meet the "misrepresents" standard.

Schmitt contends The jury instructions given were neither erroneous or prejudicial. They were derived from the law of the 3rd Circuit and anticipated perfectly the 6th Circuit's holding in *Podiatric Physicians, supra.* "Misrepresents" is the correct standard for a monetary damages claim which was the sole remaining claim BDC had when the case went to the jury. As stated before, BDC had dropped its request for injunctive relief in August 1994. The case went to trial on damages only, three years later. "Tendency to deceive" and "will likely influence" cannot establish a misrepresentation. Proof to that standard will sustain a claim for injunctive relief in some Circuits but, in a case of implied falsehood, are insufficient to establish liability for monetary damages in any Circuit (except the 6th presently). Proof of a likelihood of deception will not allow even injunctive relief under §1125(a)(1)(B) in the 2nd Circuit.

The 6th Circuit's assignment of error to the trial court's jury instructions is another clear indication of its conflict with the other Circuits. The jury instructions were noted by the trial judge to have been patterned from the elements of a damages cause of action as found in *Johnson & Johnson-Merck v. Rhone-Poulenc Rorer,* 19 F.3d 125, 129 (3rd Cir. 1994) which also cited *U.S. Healthcare, Inc. v. Blue Cross of Greater Philadelphia*, 898 F.2d 914 (3rd Cir. 1990). Such was the pattern for *Pediatric Physicians'* development of its standards. Why the 6th Circuit determined to ignore the jurisprudence and set a new standard for "loss control damages" can only be explained rationally by one motivation, they liked the result.

ARGUMENT 6 – The existence of damages susceptible of proof does not establish liability.

The 6th Circuit held "loss control damages" meet the damages element of the Lanham Act cause of action. The existence of alleged damages capable of being proven does not however, in itself, establish liability.

To establish misrepresentation, all of elements must be proven. To establish liability under §1125(a)(1)(B), BDC has the burden of proof to show Schmitt had misrepresented BDC's product. That proof must come from customers, not BDC's (or the court's) perception of their reaction. *See United Industries v Clorox*, 140 F.3d at 1183. No matter how well a party might be able to document its claimed damages, that, without proof of *all* the elements of the cause of action, will not create a liability.

To establish a party has "misrepresented" requires proof that defendant made material misrepresentation; it was false; defendant knew it was false when made, or made it recklessly, without knowledge of its truth and as a positive assertion; it was made with intention to induce reliance by plaintiff; plaintiff acted in reliance upon it; and plaintiff thereby suffered injury. *State-William-Partnership v Gale*, 169 Mich.App. 170, 425 N.W.2d 756 (1988). That, without a scienter element, is what BDC, in an implied falsehood case, *must* establish occurred and caused its injury before any relief can be granted.

ARGUMENT 7 – the final line of Section 43(a) allows standing to sue, not a standard for recovery.

The final line of 15 USC §1125(a) does not authorize recovery on the belief the claimant is or is likely to be injured. That language simply expands the class of complainants who have standing to sue. A claimant's good faith belief it is a secondary victim of the misrepresentation does not establish liability. To recover damages or gain injunctive relief a claimant must prove violation of the Act on the standard set by Congress.

Although it is not at issue here, in some Circuits, a literal falsehood allows a presumption of deception, some also allow a presumption of materiality and some even injury. Generally, on a showing of literal fallacy, injunctive relief can be obtained. Other Circuits do not allow such a presumption noting falsehood alone does not establish materiality to the purchasing decision or a resulting injury.

The Circuits are very fractured in this area and could certainly be assisted by a clarification of 15 USC 1125(a)(1)(B) by this Court. At issue here is where the communication is found not to be literally false. (That is the undisturbed finding of the trial judge.) In such circumstance, jurisprudence requires the overall communication be taken in context and its effect on the intended audience determined. It is only actionable if it is actually deceptive. The complainant's perception or the court's view are not considered reliable indicators for such determinations. The finder of fact must determine, based on evidence of the reactions of the targeted recipients, if the communication, in fact, misled a substantial portion of them, if the misleading or deceptive portion of the message was material to their

purchasing decisions, the actions took place in interstate commerce and, finally, the claimant was injured thereby.

ARGUMENT 8 - Plaintiff must prove the case.

Part of the 6th Circuit's reasoning appeared in dicta contained in the opinion. The 6th Circuit appeared concerned with the difficulty complainants might have in *proving* liability and the resulting damages. Proving a third party was misrepresented has never been easy. Proving the necessary nexus between the third parties' deception and damages to complainant always has been and will continue to be difficult. Congress must certainly be aware of such. Yet, even though it has amended the Lanham Act regularly over the years and significantly in 1988, Congress has *not* chosen to lower the complainant's burden. Indeed, the only rational reading of the 1988 amendment is that it *increased* the burden of a false commercial advertising claimant. (Perhaps to avoid the free speech issues which will arise out of the 6th Circuit's lower "likelihood" standard.)

It is the plaintiff's burden to prove its cause of action. Plaintiff must accept responsibility for the results of its reluctance or refusal to allow discovery and/or bring its proofs. Defendant is entitled to the information to formulate its defense. When presented at trial, the information provides the trier of fact the basis upon which to make its determination.

Here BDC limited discovery by entering into stipulations which, by reducing the issues, made the information irrelevant and withheld it from the purview of Schmitt. That was the reason for BDC's stipulations it would

not claim or seek to prove lost profits or change in financial position.

As a result of BDC's complaints in its briefs and argument of the difficulty to prove its case and its desire not to disclose otherwise confidential information to a competitor, the 6th Circuit gave Plaintiff the benefit of the doubt holding:

> "Further, limiting a plaintiff to injunctive relief is especially unfair where a plaintiff's inability to prove marketplace damages or actual confusion may merely reflect an understandable unwillingness to irk customers as the plaintiff pursues proof of harm."

Schmitt contends the 6th Circuit in that holding conflicts with American jurisprudence which generally holds a party which declines to meet its burden, allow discovery or bring evidence must accept the results of its decisions and failures. Schmitt contends that it is absolutely unfair and impermissible for BDC to receive any favorable inference for *not* prosecuting its case or bringing its proofs.

CONCLUSION

The 6th Circuit has created more problems that is has solved with the promulgation of its new standard. It is in direct conflict with the rest of the Circuits and inadvertently treads on the constitutional rights of the advertising community.

This Court should closely examine the issues presented here. The Petitioner urges this Court to take this opportunity to clarify and unify the national application of this law. The

present disparities in the enforcement of Section 43(a)(1)(B) among the circuits need to be resolved to enhance commerce, protect commercial speech and maximize the benefit to the persons for whom it was enacted. This law is ripe for review.

Respectfully submitted,

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APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

RECOMMENDED FOR FULL-TEXT PUBLICATION

[Filed February 25, 2000]

No. 97-2023

Balance Dynamics Corporation, *Plaintiff-Appellant,*	)
v.	)
Schmitt Industries, Incorporated, *Defendant-Appellee.*	)

Appeal from the United States District Court
for the Eastern District of Michigan at Detroit.
No. 94-75356--Robert E. DeMascio, District Judge.

Before: NELSON and DAUGHTREY, Circuit Judges; DOWD, District Judge.*

* The Honorable David D. Dowd, Jr., United States District Judge for the Northern District of Ohio, sitting by designation.

OPINION

DAVID D. DOWD, JR., District Judge.

I. Introduction

The false advertising litigation before us has continued for six years, largely due to the paucity of legal rulings available to the trial court on some of the unique issues presented in this case. These issues pertain to the standards for establishing a violation of the Lanham Trade-Mark Act, the relief available once a violation is established, and the method of proofs necessary to establish entitlement to such relief. In particular, this case presents several issues of first impression: (1) whether, upon establishing a violation of the Lanham Act, a plaintiff can recover damage control costs without showing that the false advertising created actual confusion in the marketplace or actual damages in the marketplace; (2) whether a plaintiff can recover damages to goodwill or disgorgement of profits upon showing that an advertisement is literally false or deliberately false, where the plaintiff has no other proof of damages to its business; and (3) whether out-of-state, individual corporate officers who were personally involved in a Lanham Act violation are immune from the exercise of personal jurisdiction under the fiduciary shield doctrine.

For the reasons set forth below, we hold: that a plaintiff seeking to recover damage control costs under the Lanham Act for a defendant's false advertising is not required to show that the false advertising created actual confusion or damages in the marketplace; that in order to recover damage to goodwill or disgorgement of profits, a plaintiff must show

at least some damage in the marketplace and cannot rely solely on the literal falsehood of an advertisement; and personal jurisdiction may be exercised over corporate agents based upon their minimum contacts with the forum state, as long as personal jurisdiction is not premised on the mere fact of jurisdiction over the corporation.

II. Facts and History

Plaintiff-Appellant Balance Dynamics Corporation ("Balance Dynamics"), based in Ann Arbor, Michigan, and Defendant-Appellee Schmitt Industries ("Schmitt"), based in Portland, Oregon, manufacture products that balance industrial grinders and other machines that have a spinning shaft. In a process unique in the industry, Balance Dynamics' product uses a gas called Halon 1202 which is heated and vaporized in one chamber and allowed to condense back to liquid form in another. Schmitt's products accomplish the same result by balancing the spinning shafts with motor driven metal weights.

During the late summer of 1992, prior to Chicago's International Machine Tool Show in September, Schmitt mailed and distributed a postcard cartoon to 2,500 customers or potential customers depicting a "freon balancer" at the top of a "dead wheel balancer bone pile."[1]

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[1] At the time the cartoon was mailed, Balance Dynamics referred to its product as a "freon balancer." As this appellation took on negative connotations in the wake of increasing environmental awareness, Balance Dynamics began referring to its product as a "halon balancer."

In late 1992 or early 1993, Schmitt received queries regarding its possible use of halons, freons, or other ozone-depleting materials. On March 16, 1993, Schmitt sent a letter to approximately 3,200 customers and prospective customers stating that

> Effective May 15, 1993, all products which contain or have been processed with ozone depleting substances (ODS) must have warning labels affixed. Subsequently, these substances will be banned from general use. Canada has already banned the substances. The ultimate financial responsibility for environmentally sound disposal of products containing ODS materials will rest with the end user.

After stating that Schmitt's balancing system did not use ozone depleting substances, the letter continued:

> Perhaps because one manufacturer of automatic grinding wheel balancers uses halon, this type of device has come under close scrutiny. . . Should your company operate any halon balancers, and wish to dispose of them prior to May 15, Schmitt Industries can supply an SBS Balance System as an easy replacement.

The letter was signed by defendants Wayne A. Case, Schmitt's president, and James Morgan, Schmitt's sales manager.

In April of 1993, one of Balance Dynamics' largest customers faxed the letter to Thomas Schulte, Balance Dynamics' then-vice president of sales. Schulte consequently spoke with approximately 40 individuals from 12 different corporate customers with regard to the letter. Some of these customer contacts were initiated by Schulte, others by the customers themselves. After investigation, Balance Dynamics confirmed that its halon balancer was not subject to regulation, did not require labeling, and was not slated to be banned. It then responded by making visits to customers and sending a "fact sheet" to those customers who expressed concern.

Schmitt disagreed with certain items in the "fact sheet" and hired an environmental chemist to write an opinion, which stated that Halon 1202 had "managed to slip through the regulatory net" but that it is "quite certain the EPA would regulate its production and use." It also suggested that if the EPA failed to act, a private person could obtain a court order requiring the EPA to list Halon 1202 as a regulated substance, and that "it is almost certain that in the relatively near future Halon 1202 will become very difficult to obtain." The paper was provided to approximately 12 Schmitt customers or prospective customers.

In February of 1994, Balance Dynamics brought suit against Schmitt, Wayne A. Case, and James Morgan, seeking compensatory damages, treble damages, attorney fees, disgorgement of Schmitt's profits, and an injunction restraining Schmitt from similar mailings. Balance Dynamics claimed the defendants had violated various state laws as well as the false advertising language of the Lanham Trade-Mark Act, 15 U.S.C. § 1051 *et seq.* In orders signed by Judge

George LaPlata, based on reports and recommendations ("R&Rs") of Magistrate Judge Steven D. Pepe, the district court dismissed Case and Morgan from the suit for lack of personal jurisdiction and dismissed all of Balance Dynamics' state law claims for failure to state a cause of action.

Balance Dynamics dropped its claim for injunctive relief on August 21, 1994. Balance Dynamics also stipulated that it experienced no lost sales, no lost profits, and no increased cost of seeking capital investments. However, Balance Dynamics reserved the right to seek treble damages, Schmitt's profits, damage control costs, and compensation for harm to goodwill. Schmitt then brought a supplemental motion for summary judgment on Balance Dynamics' damages claims. In August of 1995, Judge LaPlata adopted an R&R granting Schmitt's motion as to lost profits and costs but denying it as to Balance Dynamics' claim for damage control activities.

Judge LaPlata retired in 1996 and the litigation was transferred to Judge Horace W. Gilmore. Judge Gilmore signed an order, purporting to reaffirm an earlier order of Magistrate Judge Pepe, denying Balance Dynamics' punitive damages claim and declaring Balance Dynamics' disgorgement claim moot. Judge Gilmore presided over a trial for several days in April of 1997, but later recused himself and declared a mistrial. The case was then assigned to Judge Robert L. DeMascio, who conducted a trial in August of 1997.

Judge DeMascio bifurcated the trial, with the issue of liability coming first. A three-day jury trial was conducted in which Balance Dynamics called two of its principals (Thomas

Schulte and Wayne Winzenz), an expert witness (Dr. Jonathan Nimitz) and the president of Schmitt, Wayne Case. Schmitt called no witnesses, rested and moved for entry of a verdict as a matter of law under Fed. R.Civ. P. 50. The court took the Rule 50 motion under advisement and instructed the jury. Plaintiff's counsel objected to the instructions, preserving the issue for appeal. The court granted Schmitt's Rule 50 motion and the jury returned a finding of no cause of action.

The trial court entered its formal findings of fact, conclusions of law and judgment on September 17, 1997. Balance Dynamics timely filed an appeal from the final judgment and preceding interlocutory orders. Schmitt moved for attorney fees under the provision in the Lanham Act authorizing such awards in "exceptional" cases. The court denied this motion as well as a motion for reconsideration. In a companion case to Balance Dynamics' appeal, Schmitt appealed from these two orders. (Case No. 98-1143).

III. Jurisdiction

The district court correctly exercised federal question jurisdiction under 28 U.S.C. § 1331 and diversity jurisdiction under 28 U.S.C. § 1332. Appellate jurisdiction is proper under 28 U.S.C. § 1291.

IV. Schmitt's Rule 50 Motion

Rule 50 gives district courts the discretion to grant a motion for judgment as a matter of law "[i]f during a trial by jury a party has been fully heard on an issue and there is no legally sufficient evidentiary basis for a reasonable jury to find for that party on that issue." Fed. R. Civ. P. 50(a)(1).

An appeals court reviews *de novo* a district court's decision to grant judgment as a matter of law. *Jackson v. Quanex Corp.*, 191 F.3d 647, 658 (6th Cir. 1999). "Without weighing the evidence or assessing the credibility of the witnesses, and after drawing all reasonable inferences in favor of plaintiff, [an appeals court] must determine whether the record contains evidence sufficient to have allowed jurors to find in favor of plaintiff." *Monday v. Oulette,* 118 F.3d 1099, 1101-02 (6th Cir. 1997).

The Lanham Trade-Mark Act provides as follows:

> (1) Any person who, on or in connection with any goods or services, or any container for goods, uses in commerce any word, term, name, symbol, or device, or any combination thereof, or any false designation of origin, false or misleading description of fact, or false or misleading representation of fact, which--
>
> (A) is likely to cause confusion, or to cause mistake, or to deceive as to the affiliation, connection, or association of such person with another person, or as to the origin, sponsorship, or approval of his or her goods, services, or commercial activities by another person, or
>
> (B) in commercial advertising or promotion, misrepresents the nature, characteristics, qualities, or geographic origin of his or her or another person's goods, services, or commercial activities

> shall be liable in a civil action by any person who believes that he or she is or is likely to be damaged by such act.

15 U.S.C. § 1125(a). The damages to which a plaintiff may be entitled under the Lanham Act are specified in 15 U.S.C. § 1117:

> When . . . a violation under § 1125(a) of this title, shall have been established in any civil action arising under this chapter, the plaintiff shall be entitled . . . subject to the principles of equity, to recover (1) defendant's profits, (2) any damages sustained by the plaintiff, and (3) the costs of the action.

Schmitt made its oral Rule 50 motion at the close of proofs on the grounds that Balance Dynamics had failed to show actual confusion in the marketplace and was therefore not entitled to relief under the Lanham Act. The district court agreed, finding that Balance Dynamics had not met its "burden of proving that some customer, just one, was confused or changed a purchasing decision, or lost a sale of some kind."

In ruling on Schmitt's Rule 50 motion, the district court did not have the benefit of this circuit's recent decision in *American Council of Certified Podiatric Physicians and Surgeons v. American Bd. of Podiatric Surgery, Inc.*, 185 F.3d 606 (6th Cir. 1999), in which we set forth guidelines for deciding liability for false advertising claims under the Lanham Act. In *Podiatric Physicians*, which also involved appellate review of a district court's Rule 50 decision, the

court established a five-element test for plaintiffs seeking to prove liability under the Lanham Act:

> [A] plaintiff must establish the following: 1) the defendant has made false or misleading statements of fact concerning his own product or another's; 2) the statement actually deceives or tends to deceive a substantial portion of the intended audience; 3) the statement is material in that it will likely influence a deceived consumers' purchasing decisions; 4) the advertisements were introduced into interstate commerce; 5) there is some causal link between the challenged statements and harm to the plaintiff.

Id. at 613 (citing *U.S. Healthcare, Inc. v. Blue Cross of Greater Philadelphia,* 898 F.2d 922-23 (3d Cir. 1990); *ALPO Petfoods, Inc. v. Ralston Purina Co.,* 913 F.2d 958, 964 (D.C. Cir. 1990).

The second element of the *Podiatric Physicians* test shows that a plaintiff may establish a violation of the Lanham Act without proving actual confusion or a lost sale; that is, a communication that has a "tendency to deceive" can be the subject of a Lanham Act violation if all other elements of the test are met. Hence, the trial court erred in granting Schmitt's Rule 50 motion.

V. Available Relief

The posture of this case requires that we examine the forms of relief for which Balance Dynamics may be eligible

under the Lanham Act. The granting of Schmitt's Rule 50 motion is harmless error if Balance Dynamics was ineligible for any forms of relief under the Lanham Act. In addition, a remand of this case to the trial court will require a determination as to the relief to be granted. Lastly, the substantial confusion demonstrated in this case underscores the importance of clearly distinguishing the elements necessary, to prove a breach of the Lanham Act from the elements necessary to justify a certain remedy for that breach: "the inquiries should be kept separate because a violation of the Lanham Act can be remedied in more ways than one." *Web Printing Controls Co., Inc. v. Oxy-Dry Corp.*, 906 F.2d 1202 (7th Cir. 1990). Here, by not following the *Podiatric Physicians* test for establishing liability under the Lanham Act, the district court may have "read out of the Lanham Act the remedies that do not rely on proof of injury caused by actual confusion." *Web Printing Controls*, 906 F.2d at 1205.

A. Damage Control Costs

The first form of relief to which Balance Dynamics stakes a claim is that of damage control - the costs of responding to Schmitt's false advertising.[2] Balance Dynamics

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[2] *See* Magistrate Judge Pepe's Memorandum Opinion and Order of October 24, 1996 for a summary of damage control activities undertaken by Balance Dynamics. There is some question as to whether all of Balance Dynamics' claimed damage control losses really related to an effort to mitigate damages from Schmitt's false advertising, or whether Balance Dynamics was simply overreaching and seeking a windfall for activities in which it would have engaged anyway.

argues that it can receive compensation for its damage control activities without showing actual confusion or what are commonly called "actual" damages. In other words, Balance Dynamics argues that Magistrate Judge Pepe was correct as a matter of law when he recommended denying Schmitt's motion for summary judgment on the issue of loss control. The R&R that Judge LaPlata adopted states:

> In light of the inquiries made by customers and other business contacts, a factfinder could conclude that plaintiffs actions in response to Schmitt's letter were reasonable attempts to nullify any potential damage to the corporation. A factfinder could also conclude that the letter caused serious risk to plaintiffs future sales and reputation. . . . Unlike plaintiff's claim for lost profits and costs, for purposes of this issue it is irrelevant whether plaintiff *actually* suffered damage through lost or potential sales. . . . Contrary to defendants' assertion, plaintiffs "damage control activities" are recoverable under the Lanham Act, which authorizes an award for *any* damages plaintiff sustains. 15 U.S.C. § 1117(a)(2). But for Schmitt's letter, plaintiff would not have incurred any expenses because it would not have had to take any corrective action. Therefore, the cost of plaintiffs response activities, if found reasonable and necessary by a jury, constitute 'damage' under the Lanham Act."

(emphases in original).

On the other hand, Schmitt relies on *Electronics Corp. of America v. Honeywell,* 358 F.Supp. 1230 (D.Mass. 1973), to suggest that damage control costs are not recoverable in the absence of actual confusion or "actual" damages. In *Electronics Corp. of America,* plaintiff had waived any attempt to show so-called "actual business harm" in dollars and cents but nevertheless pressed its case for damages, punitive damages, costs, and attorney fees. *Id.* at 1233. The court held that the plaintiff could not recover in the absence of "actual business harm." *Id.* at 1234.

Like many other circuits, we have held that where plaintiffs seek to recover monetary damages for false or misleading advertising that is not literally false, "a violation can only be established by proof of actual deception (i.e., evidence that individual consumers perceived the advertisement in a way that misled them about the plaintiffs product)." *Podiatric Physicians,* 185 F.3d at 614 (quoting *Sandoz Pharm. Corp. v. Richardson-Vicks, Inc.,* 902 F.2d 222, 229 (3d Cir. 1990)) (citations omitted). In *Podiatric Physicians,* we also set forth a more lenient standard for obtaining injunctive relief under the Lanham Act: "injunctive relief may be obtained by showing only that the defendant's representations about its product have a tendency to deceive consumers. . . . "*Id.* at 618 (quoting *Max Daetwyler Corp. v. Input Graphics, Inc.,* 608 F.Supp. 1549, 1551 (E.D. Pa. 1985)). "This lower standard has arisen because when an injunction is sought, courts may protect the consumer without fear of bestowing an undeserved windfall on the plaintiff." *Id.*

Although *Podiatric Physicians* held that recovery of monetary damages is only available upon a showing of actual

confusion, the question of the standard upon which damage control costs may be recovered is one of first impression. None of the courts requiring actual confusion as a prerequisite to monetary recovery have applied that rule to limit recovery for damage control activities; their opinions simply were not written to take account of that kind of damages. Rather, when courts have held that actual confusion must be demonstrated before monetary damages are recoverable, they have referred to plaintiffs who were seeking damages that would have been suffered in the marketplace, i.e., lost sales, lost profits, or loss of goodwill. *See, e.g., Web Printing Controls, Inc.*, 906 F.2d at 1204-05 (plaintiff wishing to recover damages for a violation of the Lanham Act must prove "actual injury, *i.e.*, a loss of sales, profits, or present value (goodwill)."); *Podiatric Physicians, supra; PPX Enterprises, Inc. v. AudioFidelity Enterprises, Inc.*, 818 F.2d 266 (2d Cir. 1987); *Electronics Corp. of America v. Honeywell, supra.*

Actual confusion is a prerequisite to an award of such "marketplace damages" because actual confusion tends to show that these hard-to-prove damages probably exist. Yet there is no need to use such proxies with regard to damage control expenses, for the proof of such expenses is in the possession of the plaintiff and is therefore easily produced. Hence, there seems little reason to require "actual confusion" before awarding compensation for damage control expenses, even though such an award is "monetary." As Magistrate Judge Pepe noted, the plain language of the Lanham Act permits recovery of "any damages sustained by the plaintiff" upon a showing that the plaintiff is or is likely to be damaged by misrepresentative advertising. 15 U.S.C. §§ 1125(a), 1117. Magistrate Judge Pepe's view is reinforced by *Podiatric Physicians,* which allows a plaintiff to establish

liability under the Lanham Act by showing that a false advertisement has a tendency to deceive a substantial portion of the audience, and that it has caused harm to the plaintiff. 185 F.3d at 613.

Damage control expenses must be treated differently from marketplace damages because, like an injunction, damage control is undertaken precisely to prevent such things as lost sales, lost profits, and lost goodwill. As is the case with plaintiffs seeking injunctive relief, plaintiffs engaging in damage control are still at a stage where substantial uncertainty exists as to the extent of "business harm" being inflicted by the false advertising. *Cf. ALPO Petfoods, Inc. v. Ralston Purina Co.*, 997 F.2d 949, 952 (D.C. Cir. 1993). In the present case, Balance Dynamics first heard about Schmitt's March 16, 1993 letter when *a customer* faxed it to Mr. Schulte. The letter contained disparaging remarks which, if true, would ruin Balance Dynamics' business. Not yet knowing whether the letter was true or false, Schulte called his most important customers and found that most of them had received the letter and were concerned about the regulations pertaining to the halon balancer. Meanwhile, other customers initiated contact with Mr. Schulte or other officers of Balance Dynamics, and also expressed serious reservations about the continued use of the halon balancer. Balance Dynamics then investigated the veracity of the claims made in the letter and found they were false.

At this point, with 3,200 letters in circulation, must Balance Dynamics wait to take action until a customer actually tells someone at Balance Dynamics that she will not buy the halon balancer? Is Balance Dynamics limited to seeking injunctive relief to stop future letters being mailed

out, when 3,200 people are reading statements about the halon balancer that, if believed, will be fatal to Balance Dynamics' business? At such a juncture, an injunction may be a mere palliative. We think it appropriate that Balance Dynamics, upon recognizing the reasonable likelihood of confusion, would undertake to protect its business. *Cf ALPO Petfoods, Inc. v. Ralston Purina Co.*, 997 F.2d at 952. We also think it appropriate that Schmitt, having violated the Lanham Act and thereby being responsible for "any damages" caused by such violation, should compensate Balance Dynamics for any reasonable and necessary expenses incurred in mitigating the detrimental effects of that transgression. *Id.*

Consequently, similar standards as apply to injunctive relief should also apply to recovery of damage control expenses. That is, damage control expenses should be recoverable upon a showing of the likelihood of actual confusion, rather than upon a showing of actual confusion itself. This rule recognizes that it is unreasonable to expect a businessperson faced with a Lanham Act violation to sit idly by until a customer manifests actual confusion. The law should encourage quick responses and the mitigation of damage, and should not require parties to suffer an injury before trying to prevent it. Moreover, a rule allowing recovery for damage control costs upon the likelihood of actual confusion does not risk an "undeserved windfall" to the plaintiff since such an award would not speak to the underlying marketplace damages. *Cf Podiatric Physicians*, 185 F.3d at 618.

Distinct from Schmitt's argument that damage control costs are not recoverable without a showing of actual confusion is its assertion that damage control costs are not

recoverable in the absence of "actual damages" or, we assume, marketplace damages. But we find that argument similarly unacceptable. No court has excluded damage control costs from its definition of damages that are considered "actual." And several courts have awarded damages for the expense of responsive or reparative advertising quite apart from an award of marketplace damages. *See, e.g., ALPO Petfoods, Inc. v. Ralston Purina Co., supra; U-Haul Int'l, Inc. v. Jartran, Inc.*, 793 F.2d 1034, 1041 (9th Cir. 1986); *Otis Clapp & Son, Inc. v. Filmore Vitamin Co.*, 754 F.2d 738, 745 (7th Cir. 1985). Although none of these courts have awarded damage control costs in the absence of marketplace damages, none have treated marketplace injury as a prerequisite to recovery of damage control costs either. Moreover, a rule that predicated recovery of damage control expenses on a showing of marketplace damages would penalize successful efforts at mitigating damages. That is, under such a rule, a plaintiff who is successful in preventing marketplace damages would not be able to recover under the Lanham Act, but a plaintiff who is unsuccessful would be permitted to recover. That would be an anomaly.

We also note that the practical realities of business litigation favor a rule that damage control costs should be recoverable even where plaintiffs do not demonstrate actual confusion or marketplace injury. For one, marketplace damages and actual confusion are notoriously difficult and expensive to prove. *See PPX Enterprises, Inc. v. AudioFidelity Enterprises, Inc.*, 818 F.2d at 272-73; *U-Haul Int'l, Inc. v. Jartran, Inc.*, 793 F.2d at 1041. More importantly, however, even where marketplace damages or actual confusion are provable in theory, such proof often

requires that a plaintiff solicit its own customers for affidavits, which puts the customers at risk of being subpoenaed by the defendant. Plaintiffs are justifiably hesitant to alienate or upset their customers in this way. In addition, plaintiffs may hesitate to put marketplace damages at issue because that would entitle a defendant to discover information about plaintiffs business. As may have been the case here, oftentimes the rational business decision is for a plaintiff to embark on a campaign of damage control and forego a demonstration of injury in the marketplace or actual confusion of their customers. Such a plaintiff should not be required to give up compensation for its damage control expenses when the defendant's wrongful action necessitated those expenses in the first place.

Nor should plaintiffs who are unwilling or unable to prove marketplace damages or actual confusion be limited to seeking injunctive relief. An injunction can halt a wrongful activity but it will not correct its effects. Responsive advertising may be the quickest, most effective way to mitigate damages or prevent them altogether. Further, limiting a plaintiff to injunctive relief is especially unfair where a plaintiffs inability to prove marketplace damages or actual confusion may merely reflect an understandable unwillingness to irk customers as the plaintiff pursues proof of harm.

Therefore, because a company may justifiably act before it actually sustains injury, standards similar to those applicable to injunctive relief are appropriate where plaintiffs seek to recover damage control expenses. Hence, to recover loss control damages, plaintiffs must show that a violation of the Lanham Act occurred, and that (1) there was a likelihood

of confusion or damages to sales, profits, or goodwill; (2) its damage control expenses are attributable to the violation (i.e., caused by the violation); and (3) that its damage control efforts were reasonable under the circumstances and proportionate to the damage that was likely to occur.

B. Damage to Goodwill

Although Balance Dynamics stipulated that it suffered no lost sales or change in financial condition, it reserved the right to seek, *inter alia,* damages to its goodwill. To recover for damage to goodwill, the plaintiff bears the burden of proof. *Web Printing Controls Co., Inc. v. Oxy-Dry Corp.*, 906 F.2d at 1204-05; *Lithuanian Commerce Corp. v. Sara Lee Hosiery,* 47 F.Supp.2d 523, 533 (D.N.J. 1999). Schmitt contends that Balance Dynamics offered no evidence that its goodwill or reputation within the industry was actually damaged by Schmitt's communications. But Balance Dynamics presented evidence of the literal falsity of the Schmitt advertisements and also contended that Schmitt violated the Lanham Act with deliberate intent and bad faith. Though the "actual confusion" rule would ordinarily preclude Balance Dynamics' claim for goodwill, in certain circumstances the literal falsity of an advertisement or evidence of deliberate intent or bad faith has sufficed to entitle a plaintiff to certain forms of relief or to create a presumption of damages in the marketplace. The trial court seems to have acknowledged this in stating that literal falsity could prove the existence of actual confusion. However, we hold that in the present case, evidence of literal falsity and deliberate intent or bad faith does not entitle Balance Dynamics to recover money for damages to goodwill.

1. Literal Falsity

Because proof of "actual confusion" can be difficult to obtain, *Lindy Pen Co. Inc. v. Bic Pen Corp.*, 982 F.2d 1400, 1407 (9th Cir. 1993), most of the circuits have ruled that when a statement is literally false, a plaintiff need not demonstrate actual customer deception in order to obtain relief under the Lanham Act. However, the "literal falsity" rule has never permitted a plaintiff to recover marketplace damages without other proof that such damages occurred. Rather, this rule has been stated in suits in which the plaintiff sought injunctive relief, *see, e.g., United Indus. Corp. v. Clorox Co.*, 140 F.3d 1175, 1180 (8th Cir. 1998); *Seven-Up Co. v. Coca-Cola Co.*, 86 F.3d 1379, 1389 (5th Cir. 1996); *McNeil-P.C.C., Inc. v. Bristol-Myers Squibb Co.*, 938 F.2d 1544, 1549 (2d Cir. 1991); *cf Federal Trade Commission v. Brown & Williamson Tobacco Corp.*, 778 F.2d 35 (D.C. Cir. 1985); or literal falsity was not found, *see, e.g., Podiatric Physicians,* 185 F.3d at 614-18; C.B. *Fleet Co., Inc. v. Smithkline Beecham Consumer Healthcare, L.P.*, 131 F.3d 430, 434 (4th Cir. 1997); or marketplace damages were not awarded under the Lanham Act, *see, e.g., Rhone-Poulenc Rorer Pharmaceuticals, Inc. v. Marion Merrell Dow, Inc.*, 93 F.3d 511, 516 (8th Cir. 1996); *Avila v. Rubin,* 84 F.3d 222, 227 (7th Cir. 1996); or literal falsity was accompanied by other proof of marketplace damages. *See, e.g., BASF Corp. v. Old World Trading Co.*, 41 F.3d 1081, 1085-88 (7th Cir. 1994); U-*Haul Int'l v. Jartran, Inc., supra.*

At trial, Balance Dynamics attempted to show that Schmitt's advertisements were literally false. But the above cases demonstrate that literal falsity, without more, is insufficient to support an award of money damages to

compensate for marketplace injury such as harm to goodwill.[3] A contrary rule would risk conferring an undue windfall on Balance Dynamics. Balance Dynamics presented no evidence that its goodwill was harmed, or that customers were actually deceived by its advertisement.[4] To the contrary, the evidence

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[3] Our research uncovered only one case that has awarded damages based merely on the fact that an advertisement was literally false. In *PPX Enterprises, Inc. v. AudioFidelity Enterprises, Inc.*, 818 F.2d 266 (2d Cir. 1987), a record producer falsely labeled eight albums to represent that they contained performances by Jimi Hendrix. Because of the literal falsity of the packaging, the court allowed plaintiffs to prove entitlement to damages without recourse to consumer surveys, witness testimony, or reaction tests. *Id.* at 272-73. The court made clear, however, that this was a special circumstance – the misrepresentation occurred on the product itself, so actual damages were inferable from the fact that the records successfully sold on the market. *Id.* at 272. Such is not the case here.

[4] Customer inquiries were taken as evidence of actual damage to goodwill in *Criticare Systems, Inc. v. Nellcor Inc.*, 856 F.Supp. 495 (E.D. Wise. 1994), where an allegedly false letter was presented at a conference, prompting audience members to "press [plaintiff] to explain [the false] allegations during the remainder of the conference and afterwards." *Id.* at 507. From these inquiries, the court opined that a jury could reasonably conclude that the plaintiff had lost business and suffered depletion of goodwill in the marketplace. *Id. at* 508-09. But we rejected this approach in *Podiatric Physicians,* where we held that a letter of inquiry may have demonstrated some confusion but did not show that the customer was "tricked into believing an untruth about plaintiff." 185 F.3d at 617.

indicated that Balance Dynamics' business was not harmed by Schmitt's letters. Balance Dynamics' sales increased after the period in question, and there was no decrease in the price of its product. Further, Balance Dynamics admitted that no customers had ever informed it that it was losing a sale due to the Schmitt communications. While literal falsehood or the likelihood of deception may be sufficient to entitle Balance Dynamics to injunctive relief or reimbursement for responsive advertising, it should not permit Balance Dynamics to recover for injuries to goodwill in the absence of some more substantial indication that these injuries actually occurred. *Cf BASF Corp. v. Old World Trading Co.*, 41 F.3d at 1085-88 (finding literal falsity but requiring further proof of marketplace damages); *Castrol, Inc. v. Pennzoil*, 987 F.2d 939, 941-43 (3d Cir. 1993) (affirming trial court decision granting injunctive relief but denying monetary damages despite finding of literal falsity).

2. *Deliberate Intent or Bad Faith*

Though literal falsity alone does not raise an inference of damage to goodwill, some courts have created a presumption of damages when literal falsity is accompanied by deliberate intent or bad faith. The Ninth Circuit reasons that

> the expenditure by a competitor of substantial funds in an effort to deceive consumers and influence their purchasing decisions justifies the existence of a presumption that consumers are, in fact, being deceived. He who has attempted to deceive should not complain when

> required to bear the burden of rebutting a presumption that he has succeeded.

U-Haul Int'l, Inc. v. Jartran, Inc., 793 F.2d at 1040-41; *see also Southland Sod Farms v. Stover Seed Co.*, 108 F.3d 1134, 1146 (9th Cir. 1997); *Resource Developers, Inc. v. Statue of Liberty-Ellis Island Foundation, Inc.*, 926 F.2d 134, 140 (2d Cir. 1991).

In *Porous Media Corp. v. Pall Corp.*, 110 F.3d 1329 (8th Cir. 1997), the court followed the Ninth Circuit's reasoning and permitted a presumption of money damages where there existed proof of willful deception. *Id.* at 1336. However, acknowledging that a plaintiff seeking monetary relief under the Lanham Act generally must meet a higher level of proof than those seeking injunctive relief, the court clarified the presumptive damages rule as extending only to cases of comparative advertising where the plaintiff's product was specifically targeted. *Id.* at 1334-35. Otherwise, stated the *Porous Media* court, "a plaintiff might enjoy a windfall from a speculative award of damages by simply being a competitor in the same market." *Id.; see also Harper House, Inc. v. Thomas Nelson, Inc.*, 889 F.2d 197, 209 fn.8 (9th Cir. 1989).

The reasoning *of Porous Media* is applicable to the present case since Schmitt specifically targeted Balance Dynamics' balancer, which was the only product of its kind in the market. However, as stated above, the evidence shows that Balance Dynamics did not suffer marketplace injury as a result of Schmitt's advertisements. Therefore, even if the advertisements were found literally false and Balance Dynamics presented evidence of willfulness or bad faith, the

evidence defeats any presumption of damage to goodwill in the present case.

C. Disgorgement

Balance Dynamics also claims it was improperly precluded from seeking disgorgement of Schmitt's profits. In an April 21, 1997 Order Concerning Damages Available at Trial, Judge Gilmore denied as moot plaintiffs claim for defendant's sales and profits as a measure of damages. Judge Gilmore stated that this claim had already been denied in an October 17, 1996 Order of Judge LaPlata, *id.*,[5] which purportedly adopted Magistrate Judge Pepe's September 27, 1996 R&R on plaintiffs motion in limine regarding punitive damages and defendant's sales. In fact, Judge LaPlata's Order adopts Judge Pepe's August 30, 1995 R&R concerning Balance Dynamics' claims for damages based on *its own* lost sales or lost profits, and it makes no mention of disgorgement of Schmitt's profits. According to Balance Dynamics, the September 27, 1996 R&R concerning disgorgement was objected to but never ruled on. It appears Judge Pepe's September 27, 1996 R&R concerning disgorgement never received *de novo* review of the district court. Consequently, this Court will engage in such a review.

Balance Dynamics argued that because it could show that Schmitt knowingly and willfully made false statements, it was entitled to disgorgement of profits. In a closely reasoned R&R, Magistrate Judge Pepe rejected this contention

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[5] Judge LaPlata's Order was actually issued in 1995, not 1996.

and found that Balance Dynamics was only entitled to disgorgement if it could show that defendant gained additional sales due to the advertisement, or that plaintiff lost sales, or was forced to see its product at a lower price. As Magistrate Judge Pepe pointed out, § 35(a) of the Lanham Act makes clear that an award of damages shall be "subject to the principles of equity" but also states that the award is to "constitute compensation and not a penalty." Reviewing the legislative history and case law concerning disgorgement of profits, Magistrate Judge Pepe concluded that unless there is some proof that plaintiff lost sales or profits, or that defendant gained them, the principles of equity do not warrant an award of defendant's profits. We agree with and adopt Magistrate Judge Pepe's reasoning.[6]

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[6] We do not believe that the "deterrence theory," in which one of the trial court's primary functions is to make violations of the Lanham Act unprofitable to the infringing party, *See Wynn Oil Co. v. American Way Service Corp.*, 943 F.2d 595,606-07 (6th Cir. 1991) (citing *Roulo v. Russ Berrie & Co.*, 886 F.2d 931,941 (7th Cir. 1989)), supports disgorgement in this case. As Magistrate Judge Pepe noted, the cases awarding profits under the deterrence theory upon a finding of willfulness or bad faith have been infringement cases "where defendant benefits directly from its wrongful conduct." *See, e.g., International Star Class Yacht Racing Ass'n v. Tommy Hilfiger, U.S.A., Inc.*, 80 F.3d 749, 753 (2d Cir. 1996); *Roulo v. Russ Berrie & Co., Inc.*, 886 F.2d at 941. Even in false advertising cases, disgorgement has not been awarded in the absence of harm to the plaintiff or benefit to the defendant. *See, e.g., U-Haul Int'l v. Jartran, Inc.*, 793 F.2d at 1036.

VI. Trial Court's Findings of Fact

In granting Schmitt's Rule 50 motion, the trial court made two factual findings that Balance Dynamics contests. In considering the factual findings that a trial court has made in the context of granting of a Rule 50 motion, a reviewing court considers *de novo* the evidence "in the light most favorable to the non-movant, giving that party the benefit of all reasonable inferences." *Jackson v. Quanex,* 191 F.3d at 657. In ruling on a Rule 50 motion, a trial court is not permitted to "weigh the evidence or make credibility determinations, as these are jury functions." *Id.* A dismissal pursuant to Rule 50 is improper where the nonmovant presents sufficient evidence to raise a material issue of fact for the jury. *Id.*

First, the trial court acknowledged that Balance Dynamics could prove actual confusion by presenting evidence that the Schmitt communications were literally false; but it found that even Balance Dynamics' expert had been unwilling to testify that the Schmitt communications were literally false. Since we have ruled that a showing of literal falsity in this case would not have aided Balance Dynamics in its quest to recover damages to goodwill, there is no need to decide whether the trial court erred in its factual determination that Balance Dynamics presented no evidence of literal falsity.

Second, Balance Dynamics contests the trial court's finding that its damage control activities were an over-reaction to the problem. The trial court made the following factual determinations:

> the evidence really taken as a whole shows what happened here. Plaintiff got a copy of

> this letter just as Mr. Schulte testified, called a few of his partners together and began to over-react something horrible, and ran out and tried to, quote, put out the fire, when no fire was ever testified to. I don't know what fire the plaintiff is talking about. There was just no fire produced for this Court. . . . That damage that you called loss control is an over-reaction by the Plaintiff that I think the evidence on liability makes it very clear, you didn't even have to do it. You could have handled half of these customers on the telephone, but more importantly his customers included sophisticated engineers at Ford Motor Car Company, the other auto manufacturers and big companies. Engineers know just exactly what those standards are, just exactly what. . . the EPA rulings are. . . frankly I have no idea why this case has been hanging around the court for three and a half years.

Balance Dynamics protests this finding on the grounds that Mr. Schulte had testified that, after the letter was disseminated, some of his customers contacted him in reference to its claims. Schulte further stated that of those companies with whom he had initiated contact, most had received the letter. Schulte testified that his customers told him "they didn't want to necessarily have anything to do with a product that had these stipulations associated with it." He also testified that many customers were concerned about the regulation and disposal of the Balance Dynamics products.

Obviously, the trail court did not have the benefit of an articulated standard for recovery of damage control costs. Under that standard, the testimony above contradicts the trial court's conclusion that Balance Dynamics failed to put on evidence showing the existence of a "fire" to put out. The customer inquiries Balance Dynamics received could be taken as proof of the likelihood of damage, *cf. Harper House, Inc. v. Thomas Nelson, Inc.*, 889 F.2d at 210; *PPX Enterprises, Inc. v. AudioFidelity Enterprises, Inc.*, 818 F.2d at 272, and may suffice to show that the deception was material and likely to influence a purchasing decision. Further, the customer inquiries belie the proposition that Balance Dynamics' customers are so familiar with EPA regulations that Schmitt's communications would not be off-putting. Therefore, this evidence creates a material issue of fact and the trial court should have let the matter go to a jury for determination. *Jackson v. Quanex,* 191 F.3d at 647.

VII. Jury Instructions

In a laudable attempt to conserve resources in the event its decision on Schmitt's Rule 50 motion was not sustained on appeal, the trial court allowed the jury to return a verdict. If the jury's verdict in favor of Schmitt were sound, the trial court's ruling on the Rule 50 motion would be harmless. However, we agree with Balance Dynamics that the jury instructions were both infirm and prejudicial.

In reviewing the jury instructions of a trail court, an appeals court considers "whether the charge, taken as a whole, fairly and adequately submits the issues and applicable law to the jury." *United States v. Martin,* 740 F.2d 1352, 1361 (6th Cir. 1984). At trial, the court instructed the jury

that in order to recover damages relating to a particular letter, Balance Dynamics had to show the following elements: (1) a literally false or a misleading statement of fact regarding plaintiffs product; (2) that the statement actually deceived plaintiffs customer or customers; (3) that the statement actually influenced the purchasing decision of a customer or customers that plaintiff had; (4) a connection to interstate commerce; (5) that plaintiff actually lost a sale or sales from one or more of its customers as a result of defendant's statement. Plaintiff's counsel objected, preserving the issue for appeal. The jury was out for ten minutes before returning a verdict for Schmitt.

Again, the trial court lacked the benefit *of Podiatric Physicians*. That case shows that it is not necessary to show lost sales in order to establish a violation of the Lanham Act, nor is it necessary to establish that customers were actually deceived. Therefore, the jury instructions were erroneous as a matter of law and obviously prejudicial.

VIII. Dismissal of Defendants Wayne Case and James Morgan

In a November 28, 1994 Order, Judge LaPlata dismissed Schmitt employees Wayne Case and James Morgan on the grounds that the fiduciary shield doctrine frustrated the court's personal jurisdiction over them. Citing *Weller v. Cromwell Oil Co.*, 504 F.2d 927, 929 (6th Cir. 1974), the court found that personal jurisdiction was lacking because Case and Morgan were acting in their official capacity as agents for Schmitt when they signed the offending letters.

In the seminal case *of Marine Midland Bank, N.A.v. Miller,* 664 F.2d 899 (2d Cir. 1981), the fiduciary shield doctrine is formulated as follows: "if an individual has contact with a particular state only by virtue of his acts as a fiduciary of the corporation, he may be shielded from the exercise, by that state, of jurisdiction over him personally on the basis of that conduct." *Id.* at 902. In that form, the fiduciary shield doctrine prevents the exercise of personal jurisdiction whenever an out-of-state officer's contacts occur by virtue of her official capacity. However, in *Weller v. Cromwell Oil Co. the* doctrine is stated more mildly: jurisdiction over a corporate officer cannot be predicated merely upon jurisdiction over the corporation. 504 F.2d at 929.

Some courts in the Sixth Circuit have followed the *Marine Midland Bank* formulation, holding that the mere fact that an out-of-state defendant performed the alleged tortious or violative conduct while acting as a corporate agent precludes the exercise of personal jurisdiction over that person. *See, e.g., United States v. Flack,* No. 2:96-CV-122, 1997 WL 187373 at *5 (S.D. Ohio January 31, 1997); *Cincinnati Sub-Zero Products, Inc. v. Augustine Medical, Inc.,* 800 F.Supp. 1549 (S.D. Ohio 1992). But other courts have found that the exercise of jurisdiction over the agent depends on the extent of that agent's personal involvement in the conduct. *See, e.g., State of Ohio v. Browning Ferris Indus. Inc.,* No. C 86-7387, 1987 WL 16940 (N.D. Ohio March 26, 1987); *James v. HRP, Inc.,* 852 F.Supp. 620 (W.D. Mich. 1994); *Morton Walker, D.P.M.v. Robert Concoby,* __ F.Supp.2d ___, 1999 WL 1210871 (N.D. Ohio October 12, 1999). These courts exercised personal jurisdiction over corporate officers where the officers were

active participants in the tortious conduct. There is support for this approach in Sixth Circuit case law. *See Chattanooga Corp. v. Klingler,* 704 F.2d 903, 906-07 (6th Cir. 1983); *Serras v. First Tennessee Bank N. A.,* 875 F.2d 1212, 1217 (6th Cir. 1989).

While it is true that "jurisdiction over the individual officers of a corporation cannot be predicated merely upon jurisdiction over the corporation," *Weller v. Cromwell Oil Co.,* 504 F.2d at 929, we hold that the mere fact that the actions connecting defendants to the state were undertaken in an official rather than personal capacity does not preclude the exercise of personal jurisdiction over those defendants. Hence, where an out-of-state agent is actively and personally involved in the conduct giving rise to the claim, the exercise of personal jurisdiction should depend on traditional notions of fair play and substantial justice; i.e., whether she purposely availed herself of the forum and the reasonably foreseeable consequences of that availment. *See Burger King Corp. v. Rudzewicz,* 471 U.S. 462, 474 (1985); *International Shoe Co. v. Washington,* 326 U.S. 310, 316 (1945). This proposition has been applied by other circuits in the exercise of personal jurisdiction over corporate officers who actively and personally involved themselves in conduct violating the Lanham Act, notwithstanding the fact that the defendants acted as agents when they did so. *See, e.g., Committee for Idaho's High Desert v. Yost*, 92 F.3d 814, 823-24 (9th Cir. 1996); *Electronic Laboratory Supply Co. v. Cullen,* 977 F.2d 798, 807-08 (3d Cir. 1992); *Polo Fashions, Inc. v. Crafiex, Inc.,* 816 F.2d 145, 149 (4th Cir. 1987); *Donsco, Inc. v. Casper Corp.,* 587 F.2d 602, 606 (3d Cir. 1978).

The district court erred in dismissing Case and Morgan from the suit based merely on the fact that they acted as agents for the corporation. The matter will be remanded for a determination of whether their contacts with the state of Michigan were such that due process permits the exercise of personal jurisdiction over them.

IX. Disposition

The trial court's ruling on Schmitt's Rule 50 motion is REVERSED and the judgment is VACATED. The case is REMANDED to the district court for further proceedings consistent with this opinion.

APPENDIX B

UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF MICHIGAN SOUTHERN DIVISION

[Filed September 17, 1997]

No. 94-CV-75356

BALANCE DYNAMICS CORPORATION,
Plaintiff,

v.

SCHMITT INDUSTRIES, INC.,
a foreign corporation,
Defendant.

OPINION

FINDINGS OF FACT
CONCLUSIONS OF LAW

This Lanham Act false advertising case was mistrialed before another judge of this court and was reassigned to this court for another jury trial. After hearing all of the evidence presented and the parties arguments before the jury, we granted defendant's motion for judgment as a matter of law pursuant to Federal Rule of Civil Procedure 50(a). We did,

however, afford the jury an opportunity to deliberate to arrive at its verdict. We now set forth our findings which led to the conclusion that defendant's Rule 50 motion should be granted.

This case arises out of alleged misrepresentations by defendant Schmitt Industries Inc. (Schmitt) regarding plaintiff's wheel balancing system. Plaintiff Balance Dynamic Corporation (Balance Dynamics) and Schmitt are direct competitors in the sale of industrial wheel balancing machinery. Both products accomplish the same objective, however, Schmitt's product is completely mechanical, while Balance Dynamics uses Halon 1202, a high density fluid that is a type of Freon, in order to balance machinery.

Balance Dynamics claims that Schmitt has committed false advertising in violation of the Lanham Act, as evidenced by three separate documents, detailed below. First, Schmitt created and disseminated a cartoon (the Cartoon) at a September 1992 trade show that depicted certain types of balancers as junk, with a "Freon Balancer" on top of a "Dead-Wheel Balancer Bone Pile." Neither Balance Dynamics nor Halon 1202 were specifically identified in the Cartoon. The evidence revealed, however, that Balance Dynamics had once marketed its balancer as the "Freon Balancer," but abandoned that term prior to 1992. In fact, Balance Dynamics quietly changed the name from "Freon Balancer" to "Halon Balancer" because Balance Dynamics believed that the term "Freon" was not being well received in the marketplace. Moreover, sometime before 1993, Balance Dynamics again renamed and remarketed its product as the "Baladyn IV" and its sales literature described the product as using a "high density balancing fluid."

Second, on March 16, 1993 Schmitt sent a letter (the March 16 letter) to approximately 3,200 of its customers in the industry regarding the use of an ozone depleting substance for balancing systems. The March 16 letter states as follows:

> RE: Elimination of Ozone Depleting Substances (ODS) Found in Some Grinding Wheel Balancers
>
> Dear Customer:
>
> Effective May 15, 1993, all products which contain or have been processed with ozone depleting substances (ODS) must have warning labels affixes. Subsequently, these substances will be banned from general use. Canada has already banned the substances. The ultimate responsibility for environmentally sound disposal of products containing ODS materials will rest with the end user.
>
> Schmitt Industries does not now use, and has not in the past used, any ozone depleting substances in the SBS Balance System. or in any part of it's processes.
>
> In recent weeks we have received letters from many of our customers asking us for information in this regard. We are supplying this letter for those customers who have not contacted us, to assure that Schmitt Industries does not use these substances.

> Perhaps because one manufacturer of automatic grinding wheel balancers uses halon, this type of device has come under close scrutiny. Schmitt Industries has always used mechanical weights made of metal . . . not a gas or liquid.
>
> Should your company operate any halon balancers, and wish to dispose of them prior to May 15, Schmitt Industries can supply an SBS balance System as an easy replacement. . . .

Although the March 16 letter did not specifically mention Balance Dynamics, Balance Dynamics claims that those in the marketplace are likely to identify it as the "one manufacturer" that uses Halon. Schmitt admitted that it knew the "one manufacturer" it referred to was indeed Balance Dynamics.

Lastly, Schmitt hired an environmental consultant, Lorne MacGregor, to prepare a one page report entitled "Halon 1202 and the Environment" (the MacGregor report) which it distributed to only those customers that further inquired about the use of Halon after the March 16 letter. The MacGregor report concluded that "halon 1202 is an environmentally unfriendly substance, having relatively high ODP [ozone depleting potential] and GWP [global warming potential], and is likely to come under sever use restrictions in the near future. In addition, it is a relatively toxic substance."

Balance Dynamics filed suit on February 14, 1994 alleging that Schmitt's creation and dissemination of the

Cartoon, the March 1993 letter and the MacGregor memorandum constitute deceptive trade practices, product disparagement, and false advertising, in violation of section 43(a) of the Lanham Act, 15 U.S.C. § 1125(a), state common law and the Michigan Consumer Protection Act. The state claims were subsequently dismissed, therefore the Lanham Act claim was the only claim proceeding to trial.

Section 43(a) of the Lanham Act prohibits "any false designation or representation" in advertised goods in interstate commerce and provides:

> (a) Civil action
> **(1)** Any person who, on or in connection with any goods or services, or any container for goods, uses in commerce any word, term, name, symbol, or device, or any combination thereof, or any false designation of origin, false or misleading description of fact, or false or misleading representation of fact, which--
> . . . .
> **(B)** in commercial advertising or promotion, misrepresents the nature, characteristics, qualities, or geographic origin of his or her or another person's goods, services, or commercial activities,
> shall be liable in a civil action by any person who believes that he or she is or is likely to be damaged by such act.

The Sixth Circuit has not specifically addressed false advertising claims under the Lanham Act, therefore the standards set forth in other circuits are considered here. In

order to prevail on a false advertising claim, plaintiff must prove the following elements by a preponderance of the evidence:

> (1) that the defendant had made false or misleading statements as to his own, or another's product:
> (2) that there is actual deception or at least a tendency to deceive a substantial portion of the intended audience;
> (3) that the deception is material in that it is likely to influence purchasing decisions;
> (4) that the advertised goods travelled in interstate commerce; and
> (5) that there is a likelihood of injury to the plaintiff

Johnson & Johnson-Merck v. Rhone-Poulenc Rorer, 19 F.3d 125, 129 (3d Cir. 1994)(citations omitted).

Under the first element, plaintiff must demonstrate that the challenged advertisements (the Cartoon, the March 16 letter, and the MacGregor report) are either literally false or that the advertisements, though literally true, are likely to mislead and confuse customers. *McNeil-P.C.C., Inc. v. Bristol-Myers Squibb Co.*, 938 F.2d 1544, 1549 (2d Cir. 1991); *Johnson & Johnson-Merck v. Smithkline Beecham Corp.*, 960 F.2d 294 (2d Cir. 1992). Subjective claims about products, which cannot be proven either true or false, are not actionable under the Lanham Act. *Lipton v. Nature Co.*, 71 F.3d 464, 474 (2d Cir. 1995). A plaintiff must prove that the claim is false or misleading, not merely that it is unsubstantiated. *Johnson & Johnson-Merck*, 19 F.3d at 129

(quoting *Sandoz Pharmaceuticals Corp. v. Richardson-Vicks, Inc.*, 902 F.2d 222, 228 (3d Cir. 1990)).

A plaintiff's burden in proving literal falsity varies depending on the nature of the challenged advertisement. *S.C. Johnson & Son, Inc. v. Clorox Co.*, 930 F. Supp. 753, 779 (E.D.N.Y. 1996). A determination of literal falsity rests on an analysis of the message in context. *Johnson & Johnson-Merck*, 19 F.3d at 129.

In this case, Balance Dynamics contends that the Cartoon, March 16 letter and the MacGregor report contain literal falsehoods. We disagree. As to the Cartoon, there is nothing literally false about the depiction of a "freon balancer" under the heading "bone pile." Indeed, Thomas Schulte, a Vice President at Balance Dynamics, testified that it was the *implication* that Balance Dymanics' product no longer worked and deserved being in the bone pile that the made the Cartoon objectionable. Notably, Mr. Schulte also testified that Balance Dynamics no longer marketed its balancer under the name "Freon Balancer." Further, William Case, President of Schmitt, testified that the term "bone pile" is used in the industry to describe equipment that was discarded for any number of reasons, and admitted that even Schmitt's balancer ended up in the "bone pile" of its customers.

The evidence also failed to demonstrate that the March 16 letter is literally false. Balance Dynamics argues that the

first four sentences of the March 16 letter to establish literal falsehood,[1] which again provide:

> Effective May 15, 1993, all products which contain or have been processed with ozone depleting substances (ODS) must have warning labels affixes. Subsequently, these substances will be banned from general use. Canada has already banned the substances. The ultimate responsibility for environmentally sound disposal of products containing ODS materials will rest with the end user.

Although Mr. Schulte testified that he believed the first three sentences were literally false, we do not credit his testimony since it was not established that he had sufficient knowledge or experience to testify as to the truth or falsity of the statements.

We do, however, find that Balance Dynamics' expert witness, Jonathan Nimitz, was competent to testify on this issue and that his testimony failed to establish that the statements were literally false. At the most, his testimony reveals that the statements were, in his opinion, incomplete or misleading. As to the first sentence, Mr. Nimitz indicated

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[1] Balance Dynamics also complained that the statement that "perhaps because one manufacturer of automatic grinding wheel balancers uses halon, this type of device has come under close scrutiny" was at issue because the "one manufacturer" could only be Balance Dynamics. Schmitt, however, has admitted the same.

that it was true as to ODS's named in the Montreal Protocol, but not as to Halon 1202 or Balance Dynamics' product in particular. Notably, the sentence does not state that Halon 1202 does now or will in the future require a warning label; the sentence is merely a generic statement regarding ODS's, which Mr. Nimitz said was accurate. We therefore find that the first sentence is not literally false. As to the second sentence, Mr. Nimitz testified that it is false because only production of those substances have been banned; usage of those substances has not. This is simply a distinction without a difference in terms of the falsity analysis. Mr. Nimitz acknowledged that banning production will eventually lead to a ban on usage when all available quantities of the substance have been exhausted. Thus, stating that the substances will be banned from use (not production) is nothing more than a semantic error, and in no way rises to the level of a literal falsehood. The third sentence is not even at issue because Mr. Nimitz testified that it was true. There was no evidence that the fourth sentence was literally false, but was actually challenged as misleading. Accordingly, that sentence will be addressed in our analysis of misleading statements under section 43(a).

Finally, Mr. Nimitz's testimony regarding the MacGregor report amounted to nothing more than a difference of opinion between two experts in the environmental field. Although Mr. Nimitz disagreed with Mr. Macgregor's choice of words and conclusions as to the environmental impact of Halon 1202, he did not testify that anything in the report was literally false.

If a plaintiff fails to demonstrate that the challenged advertisements are literally false, it must prove that it is

deceptive or misleading, which depends on the message that is conveyed to consumers. *Johnson & Johnson-Merck*, 19 F.3d at 125. The jury must determine whether the public was, in fact, misled. *Id.* at 130. A Lanham Act plaintiff may not rely on his own determination of deceptiveness, but rather:

> bears the burden of proving actual deception by a preponderance of the evidence. Hence, it cannot obtain relief by arguing how consumers *could* react; it must show how consumers *actually do* react.

Id. (quoting Sandoz *Pharmaceuticals Corp. v. Richardson-Vicks, Inc.*, 902 F.2d 222, 228-29 (3d Cir. 1990). Courts have acknowledged that context can be a significant factor in discerning the message conveyed particularly where, as in the instant case, the target of the advertising is not the consuming public but a more well informed and sophisticated audience. *Sandoz,* 902 F.2d at 229 (citations omitted). The materials here were disseminated to customers in the industry, entities familiar with the various balancing systems and the technological and environmental aspects of them.

Based upon our conclusions above, Balance Dynamics' claims under the theory of implied falsehoods could arise only from the Cartoon, the fourth sentence of the March 16 letter and the MacGregor report. However, Balance Dynamics cannot prevail using any of these materials as a matter of law because Balance Dynamics failed to present any evidence of customer confusion in the marketplace, which is a prerequisite to recovery under this theory. See *Johnson & Johnson-Merck,* 19 F.3d at 125. Balance Dynamics failed to produce

any customer who, after reading the Cartoon, March 16 letter, or the MacGregor report, testified to being misled or deceived about Balance Dynamics or Schmitt's product. In fact, Balance Dynamics had no customer witnesses. Absent such evidence of customer reaction to Schmitt's materials, Balance Dynamics cannot maintain a false advertising claim based upon implied falsehoods.

At is essence, this case is about one companies' overreaction to the three pieces of literature because of the fact that its product contains a substance that has acquired an environmental stigma. Although Halon 1202 has not been banned from general use, other types of halons have, including the form of halon from which Halon 1202 is derived. Balance Dynamics is cognizant of the fact that there is a finite supply of Halon 1202 as a result. Balance Dynamics is also well aware that its customers are increasingly more environmentally conscious, making Balance Dynamics extremely sensitive to comments about Halon 1202. Even assuming that Schmitt's advertising literature caused Balance Dynamics some well founded concerns, those materials do not rise to the level required to maintain a false advertising claim under section 43(a) of the Lanham Act. Balance Dynamics cannot seek judicial redress against Schmitt for capitalizing on what the marketplace has perceived to be a potential weakness or concern about Balance Dynamics' product, especially where Balance Dynamics is aware of the same. Therefore, Schmitt's motion for judgment as a matter of law will be **GRANTED**.

IT IS SO ORDERED.

/s/_____
Robert E. DeMascio
United States District Judge

Dated: SEP 17 1997

APPENDIX C

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

[Filed May 1, 2000]

No. 97-2023

Balance Dynamics Corporation, *Plaintiff-Appellant,*	)
v.	)
Schmitt Industries, Incorporated, *Defendant-Appellee.*	)

BEFORE: NELSON and DAUGHTREY, Circuit Judges; and DOWD,* District Judge.

ORDER

The court having received a petition for rehearing en banc, and the petition having been circulated not only to the original panel members but also to all other active judges of this court, and no judge of this court having requested a vote

* Hon. David D. Dowd, Senior United States District Judge for the Northern District of Ohio, sitting by designation.

on the suggestion for rehearing en banc, the petition for rehearing has been referred to the original panel.

The panel has further reviewed the petition for rehearing and concludes that the issues raised in the petition were fully considered upon the original submission and decision of the case. Accordingly, the petition is denied.